Tax-exempt Healthcare In a Reformed System

BY JULIE TROCCHIO

In a reformed healthcare system with universal access to comprehensive services, will we still need "charitable" healthcare organizations that are exempt from paying taxes? This is a frequently asked question, one that reflects the ongoing public debate on healthcare organizations' tax-exempt status.

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A Charitable Purpose

The history of tax exemption of healthcare organizations has implications for the future. Our nation's first healthcare facilities were exempt from the earliest tax laws because they were seen as clearly having a charitable purpose, providing care and shelter for the sick poor who had no place else to go. The tax code has never specified that healthcare organizations such as hospitals, nursing homes, or other not-for-profit healthcare providers should be eligible for tax exemption. Rather, these organizations began and continue to derive their exemption from their charitable purpose.

"Charitable purpose" has been defined two ways through the years. From 1956 until 1969, a healthcare facility's charitable purpose was interpreted by the Internal Revenue Service as the provision of free and discounted care to low-income persons to the extent of the institution's financial ability. This criterion was changed primarily because it was believed that the Medicare and Medicaid programs would eliminate the need for free and discounted care to the poor. After 1969 "charitable" was interpreted as benefiting the general community.

These two interpretations of "charitable" (care for the poor and benefit to the community) have historic roots. More than a century ago, Lord MacNaghten, a leading authority on the English law of charity, included both aspects when he wrote, "Charity in its legal sense, comprises four principal divisions: *trusts for the relief of poverty*; trusts for the advancement of education; trusts for the advancement of religion; and trusts for *other purposes beneficial to the community*, not falling under any of the preceding heads" (emphasis added) [Restatement of Charitable Trusts, ref. in *Commissioners v. Pemsel*, A.C. 531,583 (1891)].

In a reformed healthcare system, mission-driven, not-for-profit healthcare organizations can continue to demonstrate that they serve a charitable purpose under both interpretations of "charitable": care of the poor and benefit to the community.

Care of the Poor

It is unlikely that even the most generous reform package will address all needs of all people—especially the poor and other underserved persons.

Persons who are poor and others currently going without healthcare services may fail to enroll in the new system. To receive benefits, persons in a geographic area will likely join an integrated delivery network—a group of providers offering a continuum of services to enrollees on a capitated basis. Inability to cope with government bureaucracies and other struggles of daily living may prevent many low-income, low-literacy, and otherwise troubled persons from taking advantage of programs available to them. Evidence of this is seen in underenrollment in the Special Supplemental Food Program for Women, Infants, and Children; Early and Periodic Screening, Diagnosis, and Treatment; and Medicaid.

Despite financing and other safeguards designed to prevent discrimination, some providers may not wish to treat persons struggling with poverty and other problems. Today (and predictably in the future), some providers will shun persons who are poor, are part of minority groups, or have certain physical or mental disabilities. Their reason may be outright prejudice or the belief that such persons present language, literacy, or other problems that require excessive staff and resources.

In fact, persons and families with low incomes and many problems *will* require additional attention and services if their needs are to be adequately addressed. Not all providers are prepared or willing to respond to these needs, however, even

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